



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Release Date: 5/21/2010

Date: February 25, 2010

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

UIL: 514.00-00

Legend

Date 1 =

Dear :

We have considered your ruling request dated April 2, 2008 requesting a ruling under section 514(b)(3) of the Internal Revenue Code (Code), the "Neighborhood Land Rule".

The information submitted shows that you are a church that is recognized as exempt from Federal income tax under section 501(c)(3) of the Code. You purchased and mortgaged property to expand your charitable activities. For the first five years, you rented the property to four separate tenants under three-year leases. Almost four years after the purchase date, your long range planning committee awarded a contract to an architectural firm to conduct a space and facilities study of the property to determine how you could use it to fulfill your long-range needs. One year later, the committee accepted the firm's new plan. The scheduled completion date for the renovation and conversion of your property is twelve years after purchase. The committee intends to secure the church congregation's acceptance and approval of the plan and funding strategy soon.

According to the plan, you will build a spirituality and retreat center on the property. The first floor would provide spaces for classes, lectures, study groups, meditation and other events. The second floor would provide private apartments for visiting pastors, lecturers, and retreat guests. The plan also adds a meditative garden and a parking lot. Although the existing structure is not a registered historic structure, any changes are subject to local review and approval. Since the local review board prefers renovation to demolition of historic structures, your plan recommends refurbishing the front, adding new construction and only demolishing the rear of the existing building. You forwarded your request for this ruling at least 90 days before the fifth year after acquisition.

Rulings Requested:

You have requested the following ruling:

That it is reasonably certain that the land will be used for an exempt purpose within 15 years of

its acquisition, and that the property will be exempt from the debt-financed property provisions of sections 512(b)(4) and 514 of the Code as a result of the neighborhood land rule under section 514(b)(3).

Law:

Section 512(b)(4) and 514 of the Internal Revenue Code (Code) generally imposes income tax on unrelated business taxable income from debt-financed property.

Section 514(b)(1)(A)(i) of the Code states, in part, that the term "debt-financed property" means any property which is held to produce income and with respect to which there is an acquisition indebtedness.

Section 514(b)(3)(A) of the Code provides a special rule for neighborhood land. If an organization acquires real property for the principal purpose of using the land (commencing within 10 years of the time of acquisition) in the manner described in paragraph (1)(A) for an exempt purpose and at the time of acquisition the property is in the neighborhood of other property owned by the organization which is used in such manner, the real property acquired for such future use shall not be treated as debt-financed property so long as the organization does not abandon its intent to so use the land within the 10-year period. The preceding sentence shall not apply for any period after the expiration of the 10-year period, and shall apply after the first 5 years of the 10-year period only if the organization establishes to the satisfaction of the Secretary that it is reasonably certain that the land will be used in the described manner before the expiration of the 10-year period.

Section 514(b)(3)(E) of the Code states that, in applying this paragraph to a church, a 15-year period shall be applied in lieu of the 10-year period referred to in subparagraph (A) and (B), and subparagraphs (A) and (B)(ii) shall apply whether or not the acquired land meets the neighborhood test.

Section 1.514(b)-1(d)(1)(iii) of the regulations states that the neighborhood land rule shall not apply to any property after the expiration of 10 years from the date of acquisition. Further, the neighborhood land rule shall apply after the first 5 years of the 10-year period, only if the organization establishes to the satisfaction of the Commissioner that future use of the acquired land in furtherance of the organization's exempt purpose before the expiration of the 10-year period is reasonably certain. In order to satisfy the Commissioner, the organization does not necessarily have to show binding contracts. However, it must at least have a definite plan detailing a specific improvement and a completion date, and some affirmative action toward the fulfillment of such a plan. This information shall be forwarded to the Commissioner of Internal Revenue, Washington, D.C. 20224, for a ruling at least 90 days before the end of the fifth year after acquisition of the land.

Section 1.514(b)-1(d)(3)(i) of the regulations states that the neighborhood land rule applies with respect to any structure on the land when acquired by the organization, or to the land occupied by the structure, only so long as the intended future use of the land in furtherance of the organization's exempt purpose requires that the structure be demolished or removed in order to

use the land in such a manner. Thus, during the first five years after acquisition (and for subsequent years if there is a favorable ruling in accordance with subparagraph (1)(iii) of this paragraph) improved property is not debt financed so long as the organization does not abandon its intent to demolish the existing structure and use the land in furtherance of its exempt purpose.

Section 1.514(b)-1(d)(3)(i), of the regulations, Example (4)(1) describes a university that acquires a contiguous tract of land containing an office building for the principal purpose of demolishing the office building and building a modern dormitory. Five years later the dormitory has not been constructed, and the university has failed to satisfy the Commissioner that the office building will be demolished and the land will be used in furtherance of its exempt purpose (and consequently has failed to obtain a favorable ruling under subparagraph (1)(iii) of this paragraph). In the ninth taxable year after acquisition, the university converts the office building into an administration building. Under these circumstances, during the sixth, seventh, and eighth years after acquisition, the office building is treated as debt-financed property because the office building was not demolished or removed. Therefore, the income derived from such property during these years shall be subject to tax on unrelated business income.

Section 1.514(b)-1(d)(3)(ii) of the regulations states that the neighborhood land rule does not apply to structures erected on the land after acquisition of the land.

Section 1.514(b)-1(e)(4) of the regulations states that the limitations stated in paragraph (d)(3)(1) and (ii) of this section shall similarly apply to the rules contained in this paragraph.

Analysis:

Normally, we do not treat income from real property as unrelated business taxable income unless the property is debt-financed. Debt-financed property is defined as property that is held to produce income and with respect to which there is an acquisition indebtedness under section 514(b)(1)(A)(i) of the Code. Generally, if an exempt organization purchases debt-financed property for prospective exempt use, the "neighborhood land rule" described in section 514(b)(3)(A) exempts income derived from the property from unrelated business income tax for 10 years after the date of acquisition. Churches enjoy two additional advantages under the neighborhood land rule. They do not have to meet the neighborhood test and their income is exempt from unrelated business income tax for an additional 5 years under section 514(b)(3)(E).

To benefit from the neighborhood land rule, you must meet the requirements set forth in section 1.514(b)-1(d)(1)(iii) of the regulations. First, you must establish with reasonable certainty that you will use the property to further your exempt purpose before the 15-year expiration date. To make this showing, you must forward a definite plan detailing a specific improvement, a completion date and some affirmative action toward the fulfillment of the plan to the Service with a request for a ruling at least 90 days before the end of the fifth year after acquiring the property. You forwarded this ruling request within the time specified and submitted definite plans detailing the specific improvements you will make and actions you have taken, along with an estimated completion date set well before the expiration of the 15-year time period.

However, the special rules for churches in section 1.514(b)-1(e)(4) of the regulations reference additional limitations described in sections 1.514(b)-1(d)(3)(i) and (ii) with regard to the structures on property subject to the neighborhood land rule. The limitations apply the rule to the land and the existing structure on the date of acquisition only if the intended future use of the land requires that you demolish or remove the structure in order to use the land to further your exempt purposes. The rule does not apply to structures erected on the land after acquisition. Therefore, since you did not abandon your intent to demolish the structure on your property for the first five years, the neighborhood land rule will exclude income produced by your property from tax. However, on the sixth year after acquisition, your long range planning committee accepted the architectural firm's plan, which does not require you to demolish or remove the original structures to use the property to further your exempt purposes. Like the organization described in Example (4)(1) of section 1.514(b)-1(d)(3)(i), when you accepted the plan, you abandoned your intent to demolish or remove all of the original structure to use the land to further your exempt purposes. Therefore, for the sixth and subsequent years after acquisition, the neighborhood land rule will not exclude income produced by your property from tax as unrelated business income.

Conclusion:

Based on the foregoing, we rule as follows:

It is reasonably certain that the land will be used for an exempt purpose within 15 years of its acquisition, and that the property is exempt from the debt-financed property provisions of section 512(b)(4) and 514 of the Code as a result of the neighborhood land rule under section 514(b)(3) for 5 years beginning with the date of acquisition.

Since you abandoned your intent to demolish or remove the original structure to further your exempt purpose, we rule that your plan for the property does not satisfy the requirements of section 1.514(b)-1(d)(1)(iii) of the regulations and income from your property will not be exempt from the debt-financed property provisions of sections 512(b)(4) and 514 of the Code as a result of the neighborhood land rule under section 514(b)(3) for the sixth and subsequent years after the date of acquisition.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolved questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437